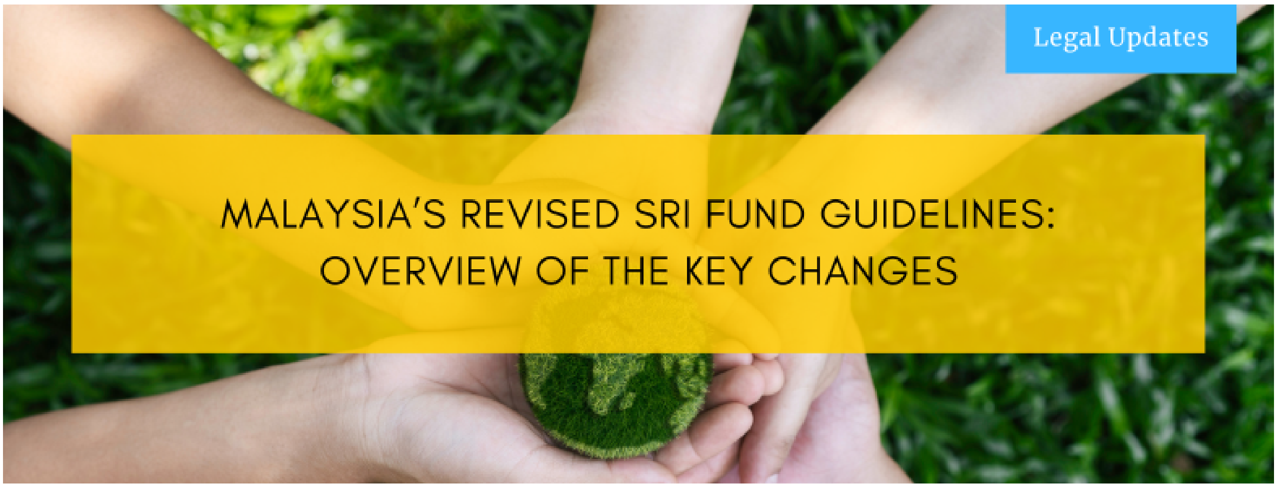

Sustainable and Responsible Investment ("**SRI**") also referred to as socially responsible investment or sustainable investing, represents an investment strategy that takes into account not only financial returns but also emphasizes positive environmental, social, and governance ("**ESG**") outcomes.

In Malaysia, SRI has gained prominence in recent years, driven by the increasing awareness of sustainability issues and the desire to support responsible business practices.

The growing size of the SRI market in Malaysia is evident, with 70 SRI funds registered with the Securities Commission Malaysia ("**SC**") as of October 2, 2023. Among these, 29 are classified as Islamic funds.[1]

The SC recognizes the importance of promoting sustainable finance especially when it aligns closely with the core principles of the Islamic capital market. Further to this, the SC has introduced regulatory frameworks aiming to stimulate the growth of SRI funds in Malaysia.

The Guidelines on SRI were initially issued by the SC on 18 December 2017, and underwent their first revision on 9 July 2021. A further revision was made on 17 February 2023, with immediate effect upon its issuance ("**2023 Guideline**").

Generally, the key amendments under the 2023 Guideline focuses on the alignment of SRI fund standards in Malaysia with the introduction of ASEAN Sustainable and Responsible Fund Standards. This alignment is crucial to broaden the range of SRI products in the Malaysian market and extending the investor base to the ASEAN region.

Additional enhancements have also been made to enhance the disclosure and reporting requirements for funds seeking SRI fund qualification.

<u>Key Changes in 2023 Revised SRI Fund Guidelines</u>

1. Three-Part Restructuring

The revised 2023 Guidelines have been re-arranged and consist of three parts, namely:

(a) Part A: Sustainable and Responsible Investment Fund

(b) Part B: ASEAN Sustainable and Responsible Fund Standards

(c) Part C: Application to Qualify as an SRI Fund and an ASEAN Sustainable and Responsible Fund

2. Introduction of requirements to qualify as an ASEAN Sustainable and Responsible Fund

An ASEAN Sustainable and Responsible Fund ("**ASEAN SRF**") is a collective investment scheme that complies with the ASEAN Sustainable and Responsible Fund Standards ("**ASEAN SRFS**"). The ASEAN SRFS were developed by the ASEAN Capital Markets Forum to provide a common set of disclosure and reporting requirements that have an ESG investment focus.

The newly ASEAN SRFS are meant to be read and complied together with the relevant securities laws, rules, and regulations of the respective ASEAN jurisdiction. Due to this, the 2023 Guideline have been revised to be aligned with the ASEAN SRFS.

Chapter 6 of the 2023 Guideline stipulates that for an SRI fund seeking qualification under the ASEAN SRFS, it must ensure compliance with the ASEAN SFRS.

3. Enhancement on the disclosure and reporting requirements

(a) Incorporation of disclosure requirement for SRI Funds that uses benchmark indices.

In the context of SRI fund, a benchmark index is a standard against which the fund's performance can be measured, taking into account the specific criteria and objectives related to socially responsible and sustainable investing. Unlike traditional benchmarks that may focus solely on financial returns, a benchmark index for an SRI fund includes criteria related to ESG and sustainable factors.

If an SRI fund opts to use an index as a reference benchmark, the SC requires disclosure on the benchmark's characteristics and composition, along with an explanation of their relevance to the fund. This disclosure will serve as key metrics and standards against which the performance and adherence of an SRI fund to sustainable and responsible practices are measured.

(b) Incorporation of sustainability risk considerations.

Disclosures must be made on the SRI fund's risks and limitations associated with its policies and strategies, including how these risks will be managed. Essentially, it imposes the obligation on the fund to transparently communicate the potential challenges and constraints associated with the fund's approach to social responsible investing and how the fund company intends to address or mitigate them through its risk mitigation policy.

(c) Voluntary Third-Party Verification

The issuer has the option to engage with a third-party to verify that the SRI fund's investments are aligned with its policies and strategies. This engagement is done on a voluntary basis. If the issuer decides to appoint a third-party verifier and subsequently releases the verification report to the public, the report must also disclose the credentials and expertise of the third-party verifier.

Although not mandatory, by voluntarily opting for third-party verification, the issuer signals a commitment to transparency and accountability. This can enhance the credibility of the SRI fund in the eyes of investors, stakeholders, and the public.

(d) Enhanced obligations of an Issuer

The 2023 Guidelines introduce detailed roles and responsibilities for the issuers. Among others, issuers are now required to consistently monitor and assess investments to guarantee compliance with the 2023 Guideline. The disclosures must detail how policies and strategies are measured and monitored throughout the fund's lifecycle, including conducting a due diligence to ensure underlying investments align with policies and strategies. These disclosures are to be made in an annual or interim report, and the details of what is required to be in the report have been laid down by the SC.

4. Implementation of a minimum asset allocation threshold

To qualify as an SRI fund, the expected exposure or minimum asset allocation percentage that is consistent with the SRI fund's policies and strategies should be at least two-thirds (2/3) of its net asset value (**NAV**) at all times. This requirement is introduced to ensure that the 2023 Guideline is in line with the ASEAN Sustainable and Responsible Fund Standards.

5. Incorporation of new investment strategies

Previously, the SC requires SRI fund to adopt one or more of the following strategies to achieve its policy:

(a) ESG integration;

(b) impact investing;

(c) negative screening;

(d) positive screening; and

(e) thematic investments.

Pursuant to the revised guideline, ethical and faith-based investing and any other ESG-related strategies (as may be authorised by the SC) has now been recognized as one of the strategies. Under the ethical and faith-based investing investment approach, funds will offer a portfolio of investments that align with specific moral or religious beliefs and values. These funds exclude companies that do not adhere to these principles through a process known as negative screening, i.e., by applying Shariah screening methodologies.

6. Extension of Income Tax Exemption for Managing an SRI Fund

In light of the announcement of Malaysia's Budget 2024, tax exemption for fund management companies managing SRI funds has been extended until 2027. Tax exemptions are granted on the income derived from fund management services to encourage market participants into the SRI market.

However, it is important to note that this tax exemption may not be applicable in a joint venture ("**JV**") structure where the joint venture company ("**JV Co**") relies on the registration and license of the JV partner to manage its SRI fund.

The SC specifies that in a JV structure, if the JV partner is already a registered corporation or a licensed fund manager, no additional registration is required for the JV Co engaged in fund management activities.[2] However, when it comes to tax exemption, such exemptions granted to the JV partner will not extend to the JV Co. As a result, even though the registration process for joint ventures with the SC is more straightforward, tax exemptions remain tied to individual entities within the joint venture structure.

In conclusion, the changes to the 2023 Guideline reflects a huge shift from the previous version of the guideline which mainly focus on the registration and submission process of an SRI fund rather than addressing the overall governance of the fund. Additionally, the amendments to the 2023 Guideline are not only designed to bring Malaysia in line with regional standards but also to stimulate the growth of SRI funds in the country.

With the revised guidelines, SRI funds are better positioned to attract a wider investor base, tapping into the expanding market of ASEAN investors who are increasingly prioritizing sustainable and responsible investment options.

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1. List of Sustainable and Responsible Investment Fund (As at 2 October 2023) https://www.sc.com.my/api/documentms/download.ashx?id=32eb683b-c134-49fb-a9d8-64b6cc44d849.
2. Frequently Asked Questions Guidelines on The Registration of Venture Capital and Private Equity Corporations and Management Corporations, Revised 28 November 2022.

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